BROITMAN DECLARATION
EXHIBIT 3

2006 Annual Report :: AT&T Inc.

Delivering on our promise

The largest communications company in the United States and one of the largest in the world

at&t

Wireless : : The No. 1 wireless provider in the country with the largest international coverage of any U.S. wireless carrier. AT&T offers unlimited calling to one of the nation's largest mobile-to-mobile and mobile-to-wireline communities and the nation's only Rollover® Minutes program.

Business : : One of the world's most advanced and powerful global backbone networks, serving all of the Fortune 1000 and offering up to 99.999 percent reliability. AT&T is a world-record holder for customer satisfaction and is recognized as an industry leader in providing services to small and midsized businesses.

IP and Broadband : : The No. 1 provider of broadband services in the United States, delivering advanced IP-based services including IPTV, Wi-Fi, WiMAX and satellite-based broadband. AT&T is the highest-ranked telecommunications operator for business customers of IP services and a recognized leader in the consumer Internet services market.

Community : : The AT&T Pioneers program is the nation's largest company-sponsored volunteer organization, and the AT&T Foundation is one of the nation's top-10 charitable-giving corporate foundations.

2006 Pro Forma Revenue Sources by Customer*

34%	26%	12%	23%	5%
Wireless	Business	Wholesale	Consumer	Directory/Other

*Pro forma revenue reflects 100 percent of AT&T Inc., BellSouth and Cingular Wireless.

To Our Stockholders

Edward E. Whitacre Jr.
Chairman
Chief Executive Officer
AT&T Inc.

AT&T is a company with a tradition of delivering on our promises. I'm pleased to report that in 2006, we continued that tradition. We promised to increase stockholder value, and we did. We promised to position our company for long-term growth, and we did.

The year also marked another step in a strategy to establish AT&T as the leader in nearly every industry segment. Our acquisition of BellSouth Corporation, which allowed us to consolidate ownership of Cingular Wireless, was the latest major step in executing that strategy. That acquisition secured AT&T's position as the global standard-bearer in communications for many years to come.

We have arrived at this point after a series of moves that transformed our company and changed the industry. And, as owners in the business, you might ask what the new AT&T is all about.

That is a fair question, which I am pleased to answer. The new AT&T is ...

The Nation's Wireless Leader

By the end of 2006, we served 61 million wireless customers. We have the nation's largest wireless digital voice and data network. And 2006 wireless revenues totaled $37.5 billion, generating our highest-ever wireless net income of $2.5 billion.

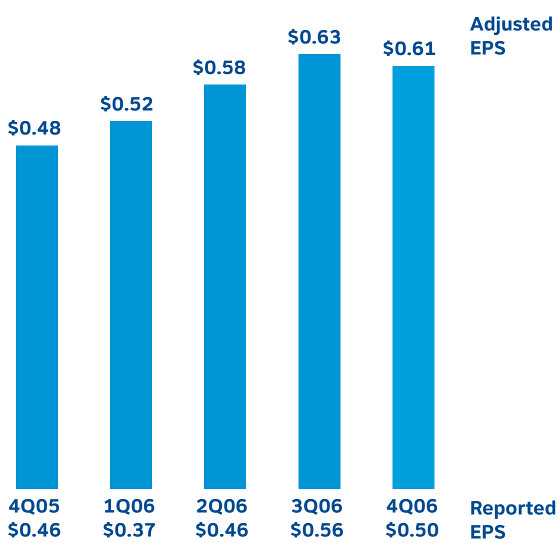
Today, we own one of the most advanced and robust wireless networks anywhere, and we are making the most of the opportunity. For example, we now offer high speed Internet access on wireless handsets in more than 165 U.S. cities, allowing customers to download videos, e-mail, games and music faster than ever. We also migrated virtually all of our wireless traffic to our advanced GSM network. Using a single worldwide technology standard like GSM makes us more cost-efficient and accelerates the rollout of next-generation products.

That's why we were selected as the only U.S. wireless carrier to sell the much-anticipated Apple iPhone. This truly revolutionary product combines a mobile phone, widescreen video iPod and Internet access into a single device.

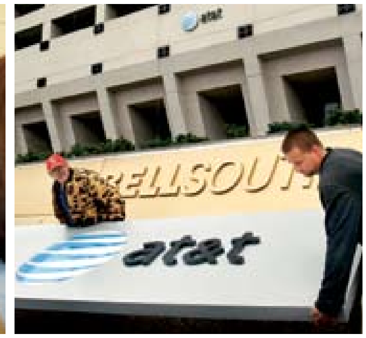
A Leader in Serving Business Customers in the United States and Around the World

In almost every category, we continued to be the U.S. leader in meeting the always-growing communications needs of businesses of all sizes.

To keep pace with our customers — and to keep ahead of our competitors — we continued to invest in state-of-the-art technology and to improve our capabilities. Our acquisition of USinternetworking strengthened our position in the growing application management services market.



AT&T has achieved seven consecutive quarters of double-digit year-over-year growth in adjusted earnings per share.



LEFT: Ed Whitacre, Chairman and CEO, greets new members of the AT&T family at a merger launch event in January 2007.

RIGHT: BellSouth rebranding began immediately after the acquisition closed on December 29, 2006.

And we expanded our reach in key Asian markets, with strategic relationships in India and Vietnam. In fact, we were the first foreign telecom operator to be granted a license to provide telecom services in India.

We also tapped new markets by making products and services originally designed for large businesses, such as network security and business-continuity services, available to small and midsized businesses. As a result, small and midsized business revenue in our local service territory grew at a double-digit pace in the second half of the year.

Leading the IP Revolution

AT&T is a leader in transitioning customers to services that rely on Internet Protocol (IP). IP technology lowers costs and allows for integrated platforms and service offerings that transform the way customers use their PCs, wireless devices and wired phones — even televisions.

Our network is the most robust in the world. It carries more than 9.59 petabytes of data traffic on an average business day — the approximate equivalent of transmitting every printed word in the Library of Congress nearly every minute. And the network reaches almost every country while delivering unrivaled reliability of up to 99.999 percent.

Our superior IP network has positioned AT&T as a premier provider of broadband service to homes and businesses. Today, including DSL, IP television service and satellite, we have more broadband lines in service — more than 12 million — than any of our competitors, and we continue to add subscribers.

Our high speed broadband has opened the door to a new opportunity — video. In fact, our IP-based AT&T U-verse[SM] service offers much more than video. AT&T U-verse completes the quadruple play of communications and entertainment services — video, voice, data and wireless.

Committed to Delivering World-Class Customer Service

New technology is exciting. However, one thing that separates us from our peers is how we treat our customers, and we are constantly evaluating how to provide the best service. We continue to implement a number of improvements in our customer service capabilities, which have allowed us to resolve even more customer issues on the first — and only — call to us.

We have introduced faster installations, which can now be done in the evenings and on weekends, and DSL plans without early termination fees.

For our business customers, we have reduced the time it takes to provide some services by as much as 75 percent and introduced innovations such as a pilot program to significantly reduce errors in customer billing. As a result of our commitment to service, AT&T has won numerous industry analyst awards for customer service, network reliability and product innovation.

Fortune Magazine's 2006 "Most Admired" Telecommunications Company in America and in the World

A Respected Leader in American Business

AT&T's industry leadership extends beyond the products and services we provide. We are proud that in the past year AT&T has been recognized for its unwavering commitment to diversity and inclusion, receiving more than 20 notable awards and recognitions.

Forbes Magazine's 2007 "Company of the Year"

An Engine for Creating Stockholder Value

By any measure, we had a great year. But I'm most proud of the value we returned to our stockholders. Our total stockholder return in 2006 was more than 53 percent, the second-highest return for all Dow industrials stocks. We also achieved our seventh consecutive quarter of adjusted double-digit year-over-year EPS growth. And adjusted EPS for the year was 36 percent higher than in 2005.

We also demonstrated our commitment to stockholder value by launching a plan to repurchase $10 billion in stock by the end of 2007, and we got a strong start toward this goal by repurchasing $2.7 billion in 2006. In addition, we increased our dividend for the 22nd consecutive year — a record unmatched in our industry.

Positioned for a Strong 2007

Given all that we have achieved, some might say that 2006 will be a tough act to follow. I disagree. In many ways, in 2006, we only set the stage for this year. As we move into 2007, our goals are to:

- Build on our success in wireless by continuing to add subscribers, generating higher data revenues and boosting margins.
- Deliver the value of the BellSouth acquisition.
- Strengthen our ability to compete in the video market as we scale our new video services.
- Grow our enterprise business.
- Continue to build AT&T as the brand that our current and future customers rely on to meet all of their communications and entertainment needs.

Most important, we'll continue to work hard to deliver value to our stockholders. I am grateful for your confidence, and I look forward to the opportunities ahead for AT&T.

Edward E. Whitacre Jr.

Edward E. Whitacre Jr.
Chairman and Chief Executive Officer
February 26, 2007

Wireless

- **The Most Wireless Subscribers.** AT&T has 61 million subscribers, with 6.8 million added in 2006 alone.
- **The Largest Footprint.** Our footprint covers 282 million people in 13,000 cities and towns and along 40,000 miles of highway.
- **Low Churn.** Down significantly year over year, churn was 1.8 percent in the fourth quarter of 2006.
- **Increasing ARPU.** Service ARPU (average revenues per user) increased in the second half of 2006, and data ARPU grew to an average of $7.19 per month in the fourth quarter, up 53 percent year over year.
- **A Fully Integrated Network.** We completed integration of our GSM networks in October.

Our efforts to consolidate our wireless operations under one brand are moving forward. We are now able to reach customers with our full spectrum of communications and entertainment offerings under the best-known and most respected name in the industry — AT&T.

Wireless is a Growing Business for AT&T

Wireless contributes approximately one-third of AT&T's pro forma revenues, and we believe that we have the industry's premier assets. Our advantage in wireless benefits our enterprise customers and supports our three-screen strategy for consumers — to integrate the wireless phone, TV and PC under a single, unified service.

RIGHT: The iPhone from Apple and AT&T will transform the way people think about wireless communications.

LEFT AND ABOVE: **AT&T retail stores are full-service sales centers. Customers can learn about and purchase wireless service and devices, as well as our AT&T U-verse and AT&T Homezone℠ video services. Our stores also offer a wide range of wireless products for business customers.**

Wireless revenue growth is driven by increased penetration of the mass market and by more demand for wireless access to e-mail and the Internet, along with the ever-increasing popularity of downloadable games, ringtones, instant messaging and video.

Nearly all of our wireless minutes are now carried on our newly integrated GSM network. With GSM technology, our wireless customers can make and receive voice calls in 190 countries and access data services in 120 countries. And in more than 165 U.S. cities, including 73 of the top 100 markets, we now offer high speed Internet access from wireless handsets and laptop computers equipped with 3G (third-generation) technology.

We offer video to wireless customers through relationships with "American Idol®," the NCAA®, HBO® and others. This summer, we will be the only U.S. wireless company to offer the revolutionary iPhone from Apple.

Wireless

AT&T Remote Monitoring℠ Service
AT&T's home-monitoring service allows customers to view live video of their home or office from virtually any wireless device with Internet connectivity, giving them peace of mind when they are away. Customers can place wireless sensors and cameras anywhere they wish. And optional add-ons include wireless temperature and water sensors and wireless power controls for lights or other appliances.

In early 2007, we announced the nation's largest unlimited free calling community. The AT&T Unity℠ plan creates a calling community of more than 100 million AT&T wireless and wireline phone numbers, including homes and businesses.

AT&T continues to demonstrate leadership in wireless entertainment. We have expanded our offerings to include the most comprehensive mobile music subscription service offered by a U.S. carrier. With content available from online retailers, such as Yahoo!® Music, Napster and XM Satellite Radio, our customers now have access to the largest collection of music content available on a wireless handset.

Businesses Depend on AT&T to Meet Their Wireless Needs

AT&T also serves more than 3 million wireless business data subscribers, including 95 percent of the Fortune 100 and 80 percent of the Fortune 500 companies.

In 2006, we introduced several new products and services to keep businesses in touch with their on-the-go employees. The 2125 Smartphone and 8100 series Pocket PC come with integrated Wi-Fi, and our 8525 Pocket PC is the first personal digital assistant in North America to use an advanced broadband technology called UMTS/HSDPA.

According to The Yankee Group's 2007 U.S. International Carrier Scorecard, AT&T ranked the highest overall because of our proven capability to deliver high-end solutions to large multinational companies.

Business

- **Global Network Reach and Reliability.** Our network reaches 97 percent of the world's economy while providing up to 99.999 percent reliability.
- **Robust IP Data Services.** IP data services revenue grew more than 12 percent in 2006, driven by gains in hosting services and virtual private networking.
- **Growth From In-Region Businesses.** 2006 revenue growth from businesses located in our local service territory was 6.5 percent.
- **Strong Wholesale Volume Growth.** Though wholesale revenues declined slightly, domestic and international volumes were at all-time highs, driven by growth in mobile traffic.

Our ability to harness the power of IP technology, our comprehensive portfolio of products and services, and our substantial network reach in the United States and throughout the world position AT&T as the networking service provider that is best able to meet the needs of business customers of all sizes.

ABOVE LEFT: Our networking solution allows Virgin Megastores to transfer point-of-sale data between locations and allows Virgin's customers to listen to music before making a purchase.

ABOVE RIGHT: In 2006, we expanded the availability of enterprise-level solutions to small and midsized businesses.

Business

AT&T Offers Networking Solutions to Businesses of All Sizes

Our customer base includes all of the Fortune 1000 companies. A significant portion of capital investment in 2006 was designed to extend global service, reach and access to these customers.

We also forged strategic partnerships in some of the world's fastest-growing markets, particularly in Asia. For example, in India, AT&T became the first foreign telecom operator to be granted a license to provide telecommunications services.

In response to rising customer demand for hosting and managed services, we expanded our network of highly secure Internet Data Centers to 32, half of which are located outside the United States. We also acquired USinternetworking, a leading applications services provider. This acquisition strengthened our position in application management services — a worldwide market estimated at $20 billion and growing.

For small and midsized businesses, we introduced several new services. These services include AT&T Remote Vault℠, a backup service for PCs and servers; AT&T Intrusion Prevention℠, which detects, contains and neutralizes known threats from hackers, viruses and worms; and network consulting services, which were once available only to enterprise customers.

ABOVE AND LEFT: Our Internet Data Centers (IDCs) deliver the most comprehensive set of hosting services that drive global commerce — from collocation of customers' servers to fully managed solutions for maintaining the Web sites of some of the world's best-known brands. IDCs also offer our hosting customers multiple levels of security.

ABOVE AND INSET: AT&T BusinessDirect® allows business customers to manage and monitor their networks remotely. For example, AT&T BusinessDirect's Network Management function allows businesses to proactively adjust their networks to meet changing business needs. In 2006, we introduced AT&T BusinessDirect Mobile, which adds convenience by connecting electronic maintenance capabilities to wireless devices.

AT&T is a global leader in the transport and termination of wholesale traffic, providing local-to-global solutions for carriers, wireless operators, cable providers, ISPs, systems integrators and content providers.

Innovation is Vital to AT&T's Continued Success With Business Customers

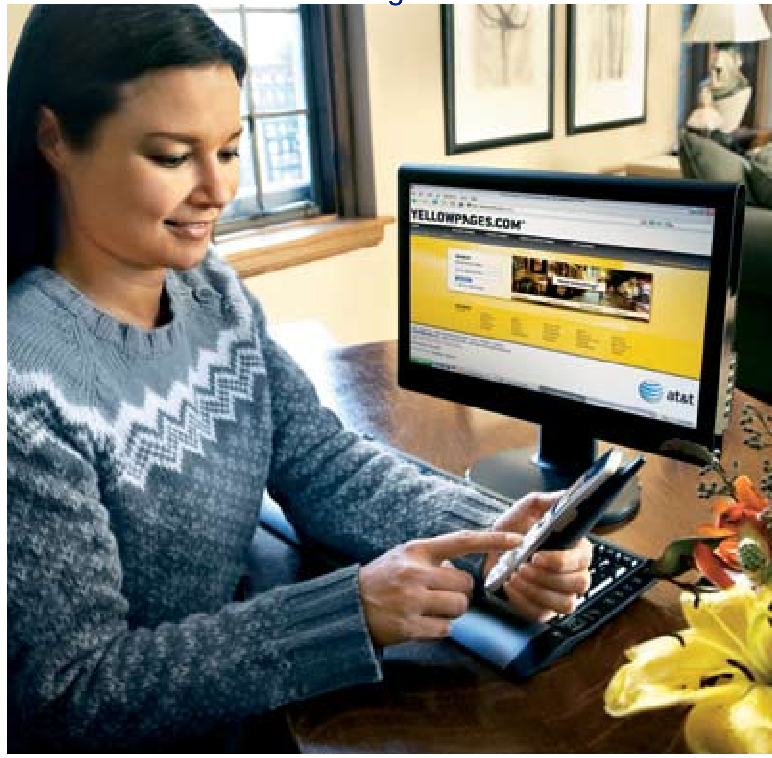
In 2007, we will continue to roll out new technologies to our customers. Anticipated innovations include an RFID solution that will help customers track the movement of products and ensure just-in-time delivery to retailers or distributors. We also plan to introduce a robust enterprise mobility offering that will allow our customers to benefit from the convergence of wireless and wireline networks.

IP and Broadband

- **Broadband Access Across Our Customer Base.** We now offer high speed Internet access to more than 80 percent of our local service customers through our network. We reach even more customers through our alliance with satellite broadband provider WildBlue.
- **Increased Broadband Penetration.** Today, AT&T has more than 12 million broadband lines in service, making us No. 1 in the United States.
- **Wi-Fi Access Around the Globe.** AT&T provides or enables Wi-Fi access at more than 47,500 locations in 79 countries.
- **Availability of AT&T U-verse TV.** In 2006, we expanded our revolutionary IP-based service, AT&T U-verse TV.

In our last annual report, we told our stockholders that we would leverage the power of IP technology to transform our business. In 2006, we strengthened our position as a leader in IP — in broadband, video and wireless.

INSET: In January 2007, we announced an agreement to sell high speed Internet service via Amazon.com.



LEFT: At the Consumer Electronics Show in January 2007, we demonstrated our next-generation products and services, showcasing AT&T U-verse and AT&T Homezone services, video-to-video wireless capabilities and AT&T CallVantage Voice over IP service.

ABOVE: The YELLOWPAGES.COM network received more than 1 billion searches for local information in 2006.

AT&T's Video Entry Will Help Drive Revenue Growth

Because we are a new entrant, we believe the video market offers significant potential upside to AT&T.

Delivered over an expanded fiber network, AT&T U-verse TV service is state of the art. Unlike cable television, U-verse TV includes digital videorecording capability as a basic service, with the ability to record up to four programs simultaneously from one set-top box. U-verse TV often offers access to more HD channels than local cable providers. U-verse subscribers now have access to more than 300 television channels, and in 2007, we plan to expand AT&T U-verse availability and add new features.

We also continue to offer video service through our existing relationships with satellite TV providers DISH Network and DIRECTV. Our AT&T Homezone service, which is now available to millions of households, combines access to DISH satellite TV with the advantages of AT&T Yahoo!® High Speed Internet service.

In January 2007, industry analyst firm Frost & Sullivan named AT&T Homezone service its "Product of the Year" for North American Consumer Communications Services.

IP and Broadband

AT&T Video Services

We are revolutionizing the television-viewing experience with AT&T U-verse TV service. More and more customers are discovering the advantages that U-verse offers, which include advanced digital videorecording capabilities, a growing library of video-on-demand titles and a wide selection of HD channels. As we continue to expand the availability of our U-verse service, we plan to offer service to approximately 19 million homes by the end of 2008 as part of our initial deployment.

With AT&T Homezone service, we are the first national telecommunications provider to offer integrated video content and TV entertainment. Frost & Sullivan recently called AT&T Homezone service "a home run for consumers and AT&T."

AT&T is Innovating to Drive Demand for Broadband Products and Services

In fall 2006, we introduced a simplified pricing structure for AT&T Yahoo! High Speed Internet service that offers greater value and flexibility. This strategy has paid off with continued subscriber growth, higher ARPU and lower customer churn. And more customers are choosing our higher-speed service packages.

In November, we announced the expansion of our sales channels. We announced that we plan to offer AT&T Yahoo! High Speed Internet service at 570 Wal-Mart stores. Customers can now also buy our broadband products from Amazon.com, which has more than 64 million active customer accounts.

In October, we relaunched AT&T blue room℠ (attblueroom.com), a Web site that houses AT&T's exclusive sports, music, gaming and entertainment content. And AT&T's YELLOWPAGES.COM unit, which includes leading Internet Yellow Pages and local search sites, continued to grow in 2006.

Through these and additional efforts, in 2007 we will further cement our position as the industry leader in IP-based technology and broadband.

We know that we are only as good as our customers say we are, which is why our focus, resources and incentive compensation systems are tied to exceeding our customers' expectations.

Customer Service

- **Improved Wireless Coverage.** AT&T reduced dropped calls and blocked calls by 15 percent and 35 percent, respectively.
- **A World Record for Enterprise Customer Service.** AT&T now holds the world record for customer satisfaction with the aggregate Top 3 customer priorities (Network Reliability, Secure Data Transfer and Network Availability) for Global Data VPN from industry analyst firm Telemark.
- **A National and Global Leader in Wholesale.** AT&T received Wholesale Carrier Excellence Awards from ATLANTIC-ACM in the global and national divisions.

AT&T is Improving Coverage and Convenience for Wireless Customers

Our commitment to improving wireless service has paid off with improved overall coverage and fewer dropped and blocked calls.

A newly redesigned Web site makes buying wireless service easier than ever. Customers can also establish a personal online account that enables them to review and pay bills, check voice minutes or data usage, access tutorials and upgrade their phones.

ABOVE LEFT: An AT&T technician offers an at-home consultation and tutorials to familiarize customers with AT&T U-verse service. We also place follow-up calls to ensure customers' satisfaction with their service.

ABOVE RIGHT: Customers continue to give us positive feedback on our Rollover Minutes program and our nationwide 30-day guarantee return policy.

Customer Service

Constant Network-Monitoring
We provide 24/7 network-monitoring from the state-of-the-art AT&T Global Network Operations Center. Threats to network performance are quickly identified and addressed, often before our customers become aware of the problem.

AT&T is Introducing Initiatives Designed to Enhance Service for Business Customers

- Reduction of the time that it takes to order and provision nodal services, from 100 days in 2002 to 25 days in 2006.
- Reductions of up to 65 percent in billing disputes and the introduction of a pilot program designed to significantly reduce billing errors. We plan to expand the program in 2007.
- Continued investment in our award-winning customer portal tools, including the December launch of AT&T BusinessDirect Mobile — a first-of-its-kind service.

Industry analyst firm IDC rated AT&T as the Best-in-Class Web Hosting Provider based on our customer service, network/number of Internet Data Centers, cost of service and service portfolio[1].

Our dedication to our small and midsized business customers has also won endorsements from industry analysts and trade associations. In October, a business survey conducted by industry analyst firm In-Stat found AT&T to be the leader among U.S. telecommunications companies in meeting the network-related needs of small and midsized businesses in the United States.

AT&T is Introducing Customer Service Initiatives for Broadband Customers

During 2006, we simplified pricing and service options for AT&T Yahoo! High Speed Internet service and for our local and long distance voice packages. We also introduced DSL plans without contract requirements or early termination fees. And we now install service during evenings and weekends.

[1] IDC, U.S. Web Hosting Buying Behaviors On-line Survey, 03/06

For more than a century, AT&T has been committed to making the communities in which we live and work as strong and vibrant as they can be. Our commitment to corporate citizenship is one of the reasons AT&T has been named by *Fortune* as "America's Most Admired Telecommunications Company" in nine out of the past 10 years and as the "World's Most Admired Telecommunications Company" eight times in the past decade.

Community

- **Funding.** In 2006, AT&T contributed more than $101 million through corporate-, employee- and AT&T Foundation-giving programs.
- **The Gift of Time.** Through the AT&T Pioneers program, nearly 350,000 employees and retirees donated time to community projects in 2006.
- **Support for Our Military.** For more than 85 years, AT&T has supported the U.S. armed forces through hiring practices, charitable contributions and sponsorships.
- **Commitment to Workforce and Supplier Diversity.** In 2006, we announced a $250 million increase in planned spending with minority-, women- and disabled veteran-owned business enterprises in our supply chain.

The AT&T Foundation and AT&T Pioneers Help to Build Stronger Communities

Over the past five years, the AT&T Foundation — among the top-10 most generous corporate foundations in the country — has provided nearly $278 million in grant funds to support nonprofit organizations that strengthen communities.

AT&T AccessAll is a $100 million initiative to deliver technology access to low-income families and underserved communities in the United States. One important initiative is a collaboration with One Economy Corporation and Habitat for Humanity affiliates and other low-income housing providers to deliver technology packages, including Internet access, to 50,000 families.

ABOVE: AT&T is dedicated to bridging the digital divide. (LEFT) Through the AccessAll program, AT&T funds computer education for recent immigrants. (RIGHT) The AT&T Foundation also provides funding to OASIS, which provides computer skills classes to older adults.

Community

A Broad View of Diversity
Our commitment to diversity is not limited to gender or ethnicity. We are also committed to providing opportunities regardless of physical limitations.

AT&T Phone Cards
Our donation of more than $6 million in prepaid calling cards allows members of the military who are deployed outside the United States to stay connected with their family and friends.

We realize that we can make a difference by investing time as well as money. We reinforce our monetary contributions through the volunteer efforts of AT&T Pioneers who devoted 14.3 million hours of their time to community projects in 2006. Pioneers' community projects support education, social needs and the environment.

AT&T Supports Those Who Protect and Defend America

In addition to our commitment to hiring veterans, since 2000 AT&T has given U.S. troops more than $6 million in prepaid calling cards and installed approximately 70 air-conditioned call centers for members of the military stationed in Iraq, Kuwait and Afghanistan.

AT&T is Committed to Workforce and Supplier Diversity

In fostering an inclusive culture and a diverse workforce, AT&T has created a better business environment — one that makes our company an employer of choice, a preferred business partner and an important contributor to the community.

AT&T is a recognized leader for diversity in hiring and contracting. Our employee base is 44 percent women and 35 percent people of color. And we work to ensure that all of our employees and suppliers have opportunities for success.

Our work in the area of diversity has been recognized by *DiversityInc* and *Fortune*, *LATINA Style* magazine, *G.I. Jobs* magazine, Catalyst, the Women's Business Enterprise National Council, the Association for Service Disabled Veterans and the Human Rights Campaign.

AT&T Inc. Financial Review 2006

Selected Financial and Operating Data

Dollars in millions except per share amounts

At December 31 or for the year ended:	2006[2]	2005[3]	2004	2003	2002
***Financial Data*[1]**					
Operating revenues	**$ 63,055**	$ 43,764	$ 40,733	$ 40,498	$ 42,821
Operating expenses	**$ 52,767**	$ 37,596	$ 34,832	$ 34,214	$ 34,383
Operating income	**$ 10,288**	$ 6,168	$ 5,901	$ 6,284	$ 8,438
Interest expense	**$ 1,843**	$ 1,456	$ 1,023	$ 1,191	$ 1,382
Equity in net income of affiliates	**$ 2,043**	$ 609	$ 873	$ 1,253	$ 1,921
Other income (expense) – net	**$ 16**	$ 14	$ 922	$ 1,767	$ 733
Income taxes	**$ 3,525**	$ 932	$ 2,186	$ 2,857	$ 2,910
Income from continuing operations	**$ 7,356**	$ 4,786	$ 4,979	$ 5,859	$ 7,361
Income from discontinued operations, net of tax[4]	**$ —**	$ —	$ 908	$ 112	$ 112
Income before extraordinary item and cumulative effect of accounting changes	**$ 7,356**	$ 4,786	$ 5,887	$ 5,971	$ 7,473
Net income[5]	**$ 7,356**	$ 4,786	$ 5,887	$ 8,505	$ 5,653
Earnings per common share:					
Income from continuing operations	**$ 1.89**	$ 1.42	$ 1.50	$ 1.77	$ 2.21
Income before extraordinary item and cumulative effect of accounting changes	**$ 1.89**	$ 1.42	$ 1.78	$ 1.80	$ 2.24
Net income[5]	**$ 1.89**	$ 1.42	$ 1.78	$ 2.56	$ 1.70
Earnings per common share – assuming dilution:					
Income from continuing operations	**$ 1.89**	$ 1.42	$ 1.50	$ 1.76	$ 2.20
Income before extraordinary item and cumulative effect of accounting changes	**$ 1.89**	$ 1.42	$ 1.77	$ 1.80	$ 2.23
Net income[5]	**$ 1.89**	$ 1.42	$ 1.77	$ 2.56	$ 1.69
Total assets	**$270,634**	$145,632	$110,265	$102,016	$ 95,170
Long-term debt	**$ 50,063**	$ 26,115	$ 21,231	$ 16,097	$ 18,578
Construction and capital expenditures	**$ 8,320**	$ 5,576	$ 5,099	$ 5,219	$ 6,808
Dividends declared per common share[6]	**$ 1.35**	$ 1.30	$ 1.26	$ 1.41	$ 1.08
Book value per common share	**$ 18.52**	$ 14.11	$ 12.27	$ 11.57	$ 10.01
Ratio of earnings to fixed charges	**5.01**	4.11	6.32	6.55	6.20
Debt ratio	**34.1%**	35.9%	40.0%	32.0%	39.9%
Weighted-average common shares outstanding (000,000)	**3,882**	3,368	3,310	3,318	3,330
Weighted-average common shares outstanding with dilution (000,000)	**3,902**	3,379	3,322	3,329	3,348
End of period common shares outstanding (000,000)	**6,239**	3,877	3,301	3,305	3,318
Operating Data					
Network access lines in service (000)[7]	**66,470**	49,413	52,356	54,683	57,083
DSL lines in service (000)[7]	**12,161**	6,921	5,104	3,515	2,199
Wireless customers (000)[8]	**60,962**	54,144	49,132	24,027	21,925
Number of employees	**302,770**	189,950	162,700	168,950	175,980

[1]Amounts in the above table have been prepared in accordance with U.S. generally accepted accounting principles.
[2]Our 2006 income statement amounts reflect results from BellSouth Corporation (BellSouth) and AT&T Mobility LLC (AT&T Mobility), formerly Cingular Wireless LLC, for the two days following the December 29, 2006 acquisition. Our 2006 balance sheet and end-of-year metrics include 100% of BellSouth and AT&T Mobility.
[3]Our 2005 income statement amounts reflect results from AT&T Corp. for the 43 days following the November 18, 2005 acquisition. Our 2005 balance sheet and end-of-year metrics include 100% of ATTC.
[4]Our financial statements for all periods presented reflect results from our sold directory advertising business in Illinois and northwest Indiana as discontinued operations. The operational results and the gain associated with the sale of that business are presented in "Income from discontinued operations, net of tax."
[5]Amounts include the following extraordinary item and cumulative effect of accounting changes: 2003, extraordinary loss of $7 related to the adoption of Financial Accounting Standards Board Interpretation No. 46 "Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51" and the cumulative effect of accounting changes of $2,541, which includes a $3,677 benefit related to the adoption of Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" and a $1,136 charge related to the January 1, 2003 change in the method in which we recognize revenues and expenses related to publishing directories from the "issue basis" method to the "amortization" method; 2002, charges related to a January 1, 2002 adoption of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets."
[6]Dividends declared by AT&T's Board of Directors reflect the following: 2003, includes three additional dividends totaling $0.25 per share above our regular quarterly dividend payout.
[7]The number presented reflects in-region lines in service (i.e., the 13 states historically served by us). The 2006 number includes BellSouth lines in service.
[8]The number presented represents, for all periods presented, 100% of AT&T Mobility cellular/PCS customers. The 2004 number includes customers from the acquisition of AT&T Wireless Services, Inc. Prior to the December 29, 2006 BellSouth acquisition, AT&T Mobility was a joint venture in which we owned 60% and was accounted for under the equity method.

Dollars in millions except per share amounts

For ease of reading, AT&T Inc. is referred to as "we," "AT&T" or the "Company" throughout this document and the names of the particular subsidiaries and affiliates providing the services generally have been omitted. AT&T is a holding company whose subsidiaries and affiliates operate in the communications services industry both domestically and internationally providing wireline and wireless telecommunications services and equipment as well as directory advertising and publishing services. You should read this discussion in conjunction with the consolidated financial statements and accompanying notes. A reference to a "Note" in this section refers to the accompanying Notes to Consolidated Financial Statements. In the tables throughout this section, percentage increases and decreases that equal or exceed 100% are not considered meaningful and are denoted with a dash.

RESULTS OF OPERATIONS

Consolidated Results Our financial results are summarized in the table below. We then discuss factors affecting our overall results for the past three years. These factors are discussed in more detail in our "Segment Results" section. We also discuss our expected revenue and expense trends for 2007 in the "Operating Environment and Trends of the Business" section.

We completed our acquisition of BellSouth Corporation (BellSouth) on December 29, 2006. We thereby acquired BellSouth's 40% economic interest in AT&T Mobility LLC (AT&T Mobility), formerly Cingular Wireless LLC (Cingular), resulting in 100% ownership of AT&T Mobility. Our consolidated results in 2006 include BellSouth's and AT&T Mobility's operational results for the final two days of the year. (Prior to the acquisition, we reported the income from our 60% share of AT&T Mobility as equity in net income (see Note 6).) We completed our acquisition of AT&T Corp. (ATTC) on November 18, 2005 and have included ATTC results during 2006 and for the 43-day period ended December 31, 2005. In accordance with U.S. generally accepted accounting principles (GAAP), operating results from BellSouth, AT&T Mobility and ATTC prior to their respective acquisition dates are excluded. Our financial statements reflect results from our sold directory advertising business in Illinois and northwest Indiana as discontinued operations (see Note 15). The operational results and the gain associated with the sale of that business are presented in the "Income From Discontinued Operations, net of tax" line item below and on the Consolidated Statements of Income.

				Percent Change	
	2006	2005	2004	**2006 vs. 2005**	2005 vs. 2004
Operating revenues	**$63,055**	$43,764	$40,733	**44.1%**	7.4%
Operating expenses	**52,767**	37,596	34,832	**40.4**	7.9
Operating income	**10,288**	6,168	5,901	**66.8**	4.5
Income before income taxes	**10,881**	5,718	7,165	**90.3**	(20.2)
Income from continuing operations	**7,356**	4,786	4,979	**53.7**	(3.9)
Income from discontinued operations, net of tax	**—**	—	908	**—**	—
Net income	**7,356**	4,786	5,887	**53.7**	(18.7)
Diluted earnings per share	**1.89**	1.42	1.77	**33.1**	(19.8)

Overview

Operating income As noted above, 2006 revenues and expenses reflect the addition of ATTC's results while our 2005 results include only 43 days. Accordingly, the following discussion of changes in our revenues and expenses is significantly affected by the ATTC acquisition. As we only include two days of operating results from BellSouth and AT&T Mobility, those results had little impact on our 2006 consolidated results. Accordingly, except where noted, when we discuss 2006 results, we will be referring only to pre-BellSouth merger AT&T operations.

Our operating income increased $4,120, or 66.8%, in 2006 and $267, or 4.5%, in 2005. Our operating income margin decreased from 14.5% in 2004 to 14.1% in 2005 and increased to 16.3% in 2006. Operating income increased primarily due to the acquisition of ATTC and reflected expense reductions through merger synergies, partially offset by additional amortization expense on those intangibles identified at the time of our acquisition of ATTC, merger-related charges for the BellSouth acquisition and by the negative effects of a continued decline in access lines. Our operating income margin decrease in 2005 reflects expense associated with a charge to terminate an agreement with WilTel Communications (WilTel) and merger-related charges.

Our operating income was slightly offset by the continued decline of retail access lines due to increased competition, as customers continue to disconnect both primary and additional lines and began using wireless and Voice over Internet Protocol (VoIP) technology offered by competitors and cable instead of phone lines for voice and data.

Operating revenues increased $19,291, or 44.1%, in 2006 and $3,031, or 7.4%, in 2005. These increases were primarily due to our acquisition of ATTC and to an increased demand for data products. The increases were slightly offset by continued pressure in voice, reflecting access line decreases and by decreased demand for local wholesale services.

Operating expenses increased $15,171, or 40.4%, in 2006 and $2,764, or 7.9%, in 2005 primarily due to our acquisition of ATTC. The 2006 increase also includes merger-integration costs associated with the BellSouth and ATTC acquisitions of $774 and amortization expense on intangible assets identified at the time of the ATTC merger of $943. Operating expenses were $330 lower due to a change in our vacation policy (see Note 2) and workforce reductions. As of December 31, 2006, we were ahead of schedule with our targeted workforce reductions associated with the ATTC acquisition.

The increase in 2005 operating expense includes a $236 charge to terminate an agreement with WilTel, merger-related asset impairments of $349 and severance accrual increases of $283 related to the ATTC acquisition. Partially offsetting these items were decreases due to expenses incurred in 2004 related to strike preparation and labor-contract settlements of $263 and to a net decrease of $186 reflecting changes in postretirement benefits in 2005 and 2004. Our significant expense changes are discussed in greater detail in our "Segment Results" sections.

Interest expense increased $387, or 26.6%, in 2006 and $433, or 42.3%, in 2005. The increase in 2006 was primarily due to recording a full year of interest expense on ATTC's outstanding debt.

The increase in 2005 was primarily due to issuing additional debt in the fourth quarter of 2004, thus accruing interest expense for a full 12 months of 2005 in comparison to less than three months of 2004. In 2004 we issued debt totaling approximately $8,750 to finance our portion of AT&T Mobility's purchase price for AT&T Wireless Services, Inc. (AWE).

Interest income decreased $6, or 1.6%, in 2006 and $109, or 22.2%, in 2005. The decrease in 2006 was primarily due to the lower average balance in 2006 on our shareholder loan to AT&T Mobility, which was partially offset by increased interest income on advances to AT&T Mobility under the terms of our revolving credit agreement (see Note 14). Prior to the December 29, 2006 acquisition of BellSouth, AT&T Mobility borrowed funds from us under a shareholder loan and revolving credit agreement. Following the BellSouth acquisition, AT&T Mobility became a wholly-owned subsidiary and our consolidated financial statements will no longer include interest income or interest expense paid from subsidiaries.

The decrease in 2005 was primarily due to lower investment balances during 2005 as investments held for the majority of 2004 were liquidated and used to fund our portion of AT&T Mobility's purchase price for AWE, and less income earned on our advances to AT&T Mobility resulting from payments during 2005 on a portion of outstanding advances due to us.

Equity in net income of affiliates increased $1,434 in 2006 and decreased $264, or 30.2%, in 2005. The increase in 2006 was primarily due to our proportionate share of AT&T Mobility's improved results of $1,308 in 2006. The 2005 decrease was due to lower results from our international holdings of $345, partially offset by an increase of $170 in our proportionate share of AT&T Mobility's results.

Investments in partnerships, joint ventures and less than majority-owned subsidiaries where we have significant influence are accounted for under the equity method. Prior to the December 29, 2006 BellSouth acquisition (see Note 2), we accounted for our 60% economic interest in AT&T Mobility under the equity method since we had been sharing control equally with BellSouth. We had equal voting rights and representation on the Board of Directors that controlled AT&T Mobility. (After the BellSouth acquisition, AT&T Mobility became a wholly-owned subsidiary of AT&T and wireless results will be reflected in operating revenues and expenses on our Consolidated Statements of Income.)

Other income (expense) – net We had other income of $16 in 2006, $14 in 2005 and $922 in 2004. There were no individually significant other income or expense transactions during 2006.

Results for 2005 primarily included a gain of $108 on the sales of shares of Amdocs Limited (Amdocs), American Tower Corp. (American Tower) and Yahoo! Inc. (Yahoo) and other miscellaneous gains. These gains were partially offset by other expenses of $126 to reflect an increase in value of a third-party minority holder's interest in an AT&T subsidiary's preferred stock and other miscellaneous expenses.

Results for 2004 primarily included a gain of $832 on the sale of our investment in Belgacom S.A., gains of $270 on the sales of shares of Amdocs and Yahoo, and a gain of $57 on the sales of shares of Teléfonos de México, S.A. de C.V. (Telmex) and América Móvil S.A. de C.V. (América Móvil). Included in items that partially offset those gains were losses of $138 on the sale of all of our shares of TDC and $82 on the sale of all of our shares of Telkom S.A. Limited.

Income taxes increased $2,593 in 2006 and decreased $1,254, or 57.4%, in 2005. Our effective tax rate in 2006 was 32.4%, compared to 16.3% in 2005 and 30.5% in 2004. The increase in income tax expense in 2006 compared to 2005 was primarily due to the higher income before income taxes in 2006 and our agreement in December 2005 with the Internal Revenue Service (IRS) to settle certain claims principally related to the utilization of capital losses and tax credits for tax years 1997-1999. The settlement resulted in our recognition of $902 of reduced income tax expense in 2005. The decrease in income taxes and our effective tax rate in 2005 compared to 2004 was due primarily to our agreement with the IRS, discussed above. (See Note 9)

Income from discontinued operations was $908 in 2004 and represents results from the directory advertising business in Illinois and northwest Indiana that we sold in 2004. (See Note 15)

Segment Results

Our segments represent strategic business units that offer different products and services and are managed accordingly. As a result of our November 18, 2005 acquisition of ATTC we revised our segment reporting to represent how we now manage our business, restating prior periods to conform to the current segments. Due to the proximity of our December 29, 2006 acquisition of BellSouth to year-end, we have reported the two days of results from BellSouth in the other segment. Our operating segment results presented in Note 4 and discussed below for each segment follow our internal management reporting. We analyze our various operating segments based on segment income before income taxes (see Note 4). Each segment's percentage of total segment operating revenue calculation is derived from our segment results table in Note 4 and reflects amounts before eliminations. Operating income percentage fluctuations were largely due to improved results in our wireless segment as well as the inclusion of ATTC in our wireline segment for all of 2006, as opposed to only 43 days in 2005. We have four reportable segments: (1) wireline, (2) wireless, (3) directory and (4) other.

The ***wireline segment*** accounted for approximately 58% of our 2006 total segment operating revenues as compared to 50% in 2005; and 54% of our 2006 total segment income as compared to 58% in 2005. This segment provides both retail and wholesale landline telecommunications services, including local and long-distance voice, switched access, Internet Protocol (IP) and Internet access data, messaging services, managed networking to business customers, our U-verse℠

video service and satellite television services through our agreement with EchoStar Communications Corp. (EchoStar).

The ***wireless segment*** accounted for approximately 37% of our 2006 total segment operating revenues as compared to 44% in 2005; and 21% of our 2006 total segment income as compared to 7% in 2005. This segment offers both wireless voice and data communications services across the United States, providing cellular and PCS services. This segment reflects 100% of the results reported by AT&T Mobility, which was our wireless joint venture with BellSouth prior to the December 29, 2006 acquisition and is now a wholly-owned subsidiary of AT&T. Although we analyze AT&T Mobility's revenues and expenses under the wireless segment, we eliminated all results from the wireless segment prior to our December 29, 2006 acquisition in our consolidated financial statements and reported our 60% proportionate share of results from that period as equity in net income of affiliates. The results from the wireless segment for the two days following the acquisition are not eliminated and are now included in the 2006 consolidated company results.

The ***directory segment*** accounted for approximately 4% of our 2006 total segment operating revenues as compared to 5% in 2005; and 12% of our 2006 total segment income as compared to 27% in 2005. This segment includes our directory operations, which publish Yellow and White Pages directories and sell directory and Internet-based advertising. This segment does not include BellSouth's directory operations for the two days following the December 29, 2006 acquisition, which are recorded in the other segment. In November 2004, a subsidiary in our directory segment entered into a joint venture agreement with BellSouth and acquired the Internet directory publisher YELLOWPAGES.COM (YPC). Following the December 29, 2006 acquisition of BellSouth, YPC became a wholly-owned subsidiary of AT&T.

The ***other segment*** accounted for approximately 1% of our 2006 and 2005 total segment operating revenues and 13% of our 2006 total segment income, as compared to 8% in 2005. This segment includes 100% of the results of BellSouth for the two days following the December 29, 2006 acquisition, as well as results from Sterling Commerce Inc. (Sterling) and from all corporate and other operations. In addition, the other segment contains our portion of the results from our international equity investments and from AT&T Mobility, prior to the December 29, 2006 acquisition, as equity in net income of affiliates. Although we analyze AT&T Mobility's revenues and expenses under the wireless segment, we record its equity in net income of affiliates in this segment. We sold our paging operations in November 2005.

The following tables show components of results of operations by segment. We discuss significant segment results following each table. We discuss capital expenditures for each segment in "Liquidity and Capital Resources." In addition, the wireless segment's 2005 operating revenue and expense percentage increases and decreases are not considered meaningful due to AT&T Mobility's fourth-quarter 2004 acquisition of AWE, and are denoted with a dash.

Wireline
Segment Results

				Percent Change	
	2006	2005	2004	**2006 vs. 2005**	2005 vs. 2004
Segment operating revenues					
Voice	**$33,908**	$24,484	$23,553	**38.5%**	4.0%
Data	**18,068**	10,734	9,046	**68.3**	18.7
Other	**6,500**	4,287	3,850	**51.6**	11.4
Total Segment Operating Revenues	**58,476**	39,505	36,449	**48.0**	8.4
Segment operating expenses					
Cost of sales	**26,206**	17,945	16,412	**46.0**	9.3
Selling, general and administrative	**14,305**	9,912	8,821	**44.3**	12.4
Depreciation and amortization	**9,614**	7,426	7,322	**29.5**	1.4
Total Segment Operating Expenses	**50,125**	35,283	32,555	**42.1**	8.4
Segment Income	**$ 8,351**	$ 4,222	$ 3,894	**97.8%**	8.4%

Operating Margin Trends

Our wireline segment operating income margin was 14.3% in 2006, compared to 10.7% in 2005 and 2004. Our wireline segment operating income increased $4,129 in 2006 and $328 in 2005. The improving operating income and margin primarily reflects incremental revenue and expenses from our acquisition of ATTC for the year in 2006 and for the last 43 days in 2005, as well as lower expenses as a result of merger synergies. This improvement was partially offset by additional amortization expense and lower voice revenue as a result of continued in-region (i.e., the 13 states historically served by us) access line declines due to increased competition, as customers disconnected lines and switched to competitors' alternative technologies, such as wireless and VoIP, for voice and data.

The improvement in our wireline segment operating income in 2005 was due primarily to the continued growth in our data and long-distance revenues, which more than offset the loss of voice revenue. During 2005, our operating income margin was pressured on the cost side due to a charge to terminate an existing agreement with WilTel and by higher costs caused by our growth initiatives in long distance and DSL. Additionally, our co-branded AT&T | DISH Network satellite TV service, sales in the large-business market and higher repair costs caused by severe weather in our traditional regions also put pressure on our operating income margin.

Voice revenues increased $9,424, or 38.5%, in 2006 and $931, or 4.0%, in 2005 primarily due to the acquisition of ATTC. Included in voice revenues are revenues from long distance, local voice and local wholesale services. Voice revenues do not include any of our VoIP revenues, which are included in data revenues.

- Long-distance revenues increased $9,268 in 2006 and $1,673 in 2005. The increase in long-distance revenues in 2006 was driven almost entirely by the acquisition of ATTC. Also contributing to the increase in 2006 were higher long-distance penetration levels. However, our long-distance revenue growth continued to slow in 2006, reflecting continuing market maturity and a continuing decline in ATTC's mass-market customers. Competitive pricing for large-business customers also contributed to slowing long-distance revenue growth in 2006. The increase in long-distance revenues in 2005 was driven primarily by the acquisition of ATTC. Also contributing to the increase in 2005 were increases in long-distance penetration levels and sales of combined long-distance and local calling fixed-fee offerings (referred to as "bundling"). These increases were partially offset by continued market maturity, which slowed revenue growth in 2005.
- Local voice revenues increased $708 in 2006 and decreased $607 in 2005. The increase in local voice revenues in 2006 primarily reflects our acquisition of ATTC. However, we expect that revenues from ATTC's mass-market customers will continue to decline on a sequential quarterly basis. Local voice revenues in 2006 and 2005 were negatively impacted by continued declines in customer demand, calling features (e.g., Caller ID and voice mail), inside wire and retail payphone revenues. We expect our local voice revenue to continue to be negatively affected by increased competition, including customers shifting to competitors' wireless and VoIP technology for voice, and the disconnection of additional lines for DSL service and other reasons. Partially offsetting these demand-related declines in 2006 were revenue increases related to pricing increases for regional telephone service and calling features.
- Lower demand for local wholesale services, primarily due to the decline in Unbundled Network Element-Platform (UNE-P) lines, decreased revenue $552 in 2006 and $135 in 2005. Lines provided under the former UNE-P rules (which ended in March 2006) declined, as competitors moved to alternate arrangements to serve their customers or their customers chose an alternative technology. (UNE-P lines are classified as wholesale in the "Access Line Summary" table.) In 2006, these demand-related decreases were partially offset by price increases as we entered into long-term contracts with our competitors. Competitors who represented a majority of our UNE-P lines have signed commercial agreements with us and therefore remain our wholesale customers. For the remaining UNE-P lines, we believe, based on marketing research, that customers primarily switched to competitors using alternative technologies or their own networks as opposed to returning as our retail customers.

Data revenues increased $7,334, or 68.3%, in 2006 and $1,688, or 18.7%, in 2005. The increase in data revenues was due to increases in IP data of $2,846 in 2006 and $931 in 2005, increases in transport of $2,427 in 2006 and $433 in 2005 and increases in packet switched services of $2,061 in 2006 and $324 in 2005, all of which increased predominantly due to the acquisition of ATTC. Data revenues accounted for approximately 31% of our wireline operating revenues in 2006, 27% in 2005 and 25% in 2004.

Included in IP data revenues are DSL, dedicated Internet access, Virtual Private Network (VPN) and other hosting services. Contributing to the increase in IP data services was continued growth in DSL, our broadband Internet-access service. DSL service increased data revenues $427 in 2006 and $444 in 2005, reflecting an increase in DSL lines in service and, in 2005, was partially driven by lower-priced promotional offerings as a response to competitive pricing pressures. Revenue from our VPN product also contributed to IP data growth in 2006.

Our transport services, which include DS1s and DS3s (types of dedicated high-capacity lines), and SONET (a dedicated high-speed solution for multi-site businesses), represented approximately 50% of total data revenues in 2006, 61% of total data revenues in 2005 and 67% of total data revenues in 2004. This decrease in percentage was primarily driven by higher revenue growth from IP-based technology, slightly offset by revenue growth from transport services. Revenue growth in 2006 was due to an increase in demand for transport services partially offset by competitive pricing.

Our packet switched services includes Frame Relay, asynchronous transfer mode (ATM) and managed packet services. As customers continue to shift from this traditional technology to IP-based technology, we expect these services to decline as a percentage of our overall data revenues.

Other operating revenues increased $2,213, or 51.6%, in 2006 and $437, or 11.4%, in 2005. The 2006 increase was primarily due to incremental revenue from our acquisition of ATTC. Major items included in other operating revenues are integration services and customer premises equipment, outsourcing, directory and operator assistance services and government-related services, which account for more than 67% of total revenue for all periods. Our co-branded AT&T | DISH Network satellite TV service increased revenue $36 in 2006 and $196 in 2005. Our AT&T | DISH revenue growth in 2006 moderated due to the restructuring of our agreement with EchoStar in September 2005, which put us on a commission basis when signing up future customers. Price increases, primarily in directory assistance, increased revenues $35 in 2006 and $23 in 2005. Revenue also increased $70 from intellectual property license fees in 2006.

Cost of sales expenses increased $8,261, or 46.0%, in 2006 and $1,533, or 9.3%, in 2005. The 2006 increase was primarily due to recording additional expenses resulting from the acquisition of ATTC. Cost of sales consists of costs we incur in order to provide our products and services, including costs of operating and maintaining our networks. Costs in this category include our repair technicians and repair services, certain network planning and engineering expenses, operator services, information technology, property taxes related to

elements of our network and payphone operations. Pension and postretirement costs, net of amounts capitalized as part of construction labor, are also included to the extent that they are allocated to our network labor force and other employees who perform the functions listed in this paragraph.

In addition to the impact of the ATTC acquisition, cost of sales in 2006 increased due to the following:

- Higher nonemployee-related expenses such as contract services, agent commissions and materials and supplies costs, of $163.
- Higher in-region benefit expenses, consisting primarily of our combined net pension and postretirement cost, increased expense $159, primarily due to changes in our actuarial assumptions, which included the reduction of our discount rate from 6.00% to 5.75% (which increases expense), and amortization of net losses on plan assets in prior years.
- Higher traffic compensation expenses (for access to another carrier's network) of $109 primarily due to increased volume of local traffic (telephone calls) terminating on competitor networks and wireless customers.
- Salary and wage merit increases and other bonus accrual adjustments of $48.

Partially offsetting these increases, cost of sales in 2006 decreased due to:

- Equipment sales and related network integration services decreased $418 primarily due to lower demand and as a result of the September 2005 amendment of our agreement for our co-branded AT&T | DISH Network satellite TV service. Prior to restructuring our relationship with EchoStar in September 2005, we had been recording both revenue and expenses for AT&T | DISH Network satellite TV customers, resulting in relatively high initial customer acquisition costs. Costs associated with equipment for large-business customers (as well as DSL and, previously, satellite video) typically are greater than costs associated with services that are provided over multiple years.
- Lower employee levels, primarily salary and wages, decreased expenses $296.
- A change made during 2006 in our policy regarding the timing for earning vacation days decreased expenses $225.
- Merger severance expenses in the prior year were higher than in the current year by $176.
- In-region weather-related repair costs incurred in 2005 decreased expenses $100 in 2006.
- Severance expenses in the prior year were higher than in the current year by $73.

In addition to the impact of ATTC, cost of sales in 2005 increased due to the following:

- Higher traffic compensation expenses of $330 primarily due to growth in our long-distance service.
- Higher equipment sales and related network integration services of $195 reflecting our emphasis on growth in DSL and sales in the large-business market and video.
- Merger severance accruals in 2005 of $176.
- Salary and wage merit increases and other bonus accrual adjustments of $170.
- Repair costs related to severe weather increased expenses $100.

Partially offsetting these increases, cost of sales in 2005 decreased due to:

- Lower employee levels decreased expenses, primarily salary and wages, by $322.
- In-region benefit expenses (consisting primarily of our combined net pension and postretirement cost) decreased $154 due to the one-time accrual in 2004 for a retiree bonus as a result of the settlement of our labor-contract negotiations, $12 as a result of changes made in 2005 to medical coverage for most managers and $20 related to changes in phone concessions for out-of-region retirees.
- Nonemployee-related expenses such as contract services, agent commissions and materials and supplies costs decreased $100.

Selling, general and administrative expenses increased $4,393, or 44.3%, in 2006 and $1,091, or 12.4%, in 2005. The 2006 increase was primarily related to recording increased expenses due to the acquisition of ATTC. Selling, general and administrative expenses consist of our provision for uncollectible accounts; advertising costs; sales and marketing functions, including our retail and wholesale customer service centers; centrally managed real estate costs, including maintenance and utilities on all owned and leased buildings; credit and collection functions; and corporate overhead costs, such as finance, legal, human resources and external affairs. Pension and postretirement costs are also included to the extent that they relate to employees who perform the functions listed in this paragraph.

In addition to the impact of the ATTC acquisition, selling, general and administrative expenses in 2006 also increased due to the following:

- Other in-region wireline segment costs of $809 primarily due to advertising costs related to promotion of the AT&T brand name. In addition, other advertising expenses increased $117.
- Higher nonemployee-related expenses, such as contract services, agent commissions and materials and supplies costs of $103.
- Higher in-region benefit expenses, consisting primarily of our combined net pension and postretirement cost, increased expense $73, primarily due to changes in our actuarial assumptions, which included the reduction of our discount rate from 6.00% to 5.75% (which increases expense) and net losses on plan assets in prior years.

Partially offsetting these increases, selling, general and administrative expenses in 2006 decreased due to:

- ATTC merger-related asset impairment charges of $349 and merger-related severance expense of $107 in the prior year resulted in lower expenses in 2006.
- Lower employee levels, primarily salary and wages, decreased expenses by $239.
- Expenses decreased in 2006 due to a charge of $236 in 2005 to terminate existing agreements with WilTel, which will continue to provide transitional and out-of-market long-distance services under a new agreement, which commenced in November 2005 as a result of our acquisition of ATTC.
- A change made during 2006 in our policy regarding the timing for earning vacation days decreased expenses $96.

- Our provision for uncollectible accounts decreased $87, as we experienced fewer losses from our retail customers and a decrease in bankruptcy filings by our wholesale customers.

In addition to the impact of ATTC, selling, general and administrative expenses in 2005 increased due to:

- ATTC merger-related asset impairment charges of $349 and merger-related severance expense of $107 increased expenses.
- Expenses increased due to a charge of $236 to terminate an existing agreement with WilTel.
- Salary and wage merit increases and other bonus accrual adjustments increased expenses $108.

Partially offsetting these increases, expenses in 2005 decreased due to the following:

- Lower employee levels decreased expenses, primarily salary and wages, by $264.
- In-region benefit expenses (consisting primarily of our combined net pension and postretirement cost) decreased $79 due to the one-time accrual in 2004 for a retiree bonus as a result of the settlement of our labor contract negotiations, $66 as a result of changes made to management medical coverage in 2005 and $73 related to changes in phone concessions for out-of-region retirees.
- Lower nonemployee-related expenses, such as contract services, agent commissions and materials and supplies costs of $59.
- Our provision for uncollectible accounts decreased $55, as we experienced fewer losses from our retail customers and a decrease in bankruptcy filings by our wholesale customers.

Depreciation and amortization expenses increased $2,188, or 29.5%, in 2006 and $104, or 1.4%, in 2005 primarily due to higher depreciable and amortizable asset bases as a result of the ATTC acquisition.

Supplemental Information

Access Line Summary Our in-region switched access lines at December 31, 2006 and 2005 are shown below and access line trends are addressed throughout this segment discussion.

Wireline In-Region[1]
Switched Access Lines

				Percent Change	
(In 000s)	**2006**	2005	2004	**2006 vs. 2005**	2005 vs. 2004
Retail Consumer					
Primary	**21,841**	22,793	23,206	**(4.2)%**	(1.8)%
Additional	**3,466**	3,890	4,322	**(10.9)**	(10.0)
Retail Consumer Subtotal	**25,307**	26,683	27,528	**(5.2)**	(3.1)
Retail Business	**17,136**	17,457	17,552	**(1.8)**	(0.5)
Retail Subtotal	**42,443**	44,140	45,080	**(3.8)**	(2.1)
Percent of total switched access lines	**91.7%**	89.3%	86.1%		
Wholesale					
Sold through ATTC	**1,044**	1,638	2,337	**(36.3)**	(29.9)
Sold to other CLECs[2]	**2,571**	3,300	4,509	**(22.1)**	(26.8)
Wholesale Subtotal	**3,615**	4,938	6,846	**(26.8)**	(27.9)
Percent of total switched access lines	**7.8%**	10.0%	13.1%		
Payphone (Retail and Wholesale)	**249**	335	430	**(25.7)**	(22.1)
Percent of total switched access lines	**0.5%**	0.7%	0.8%		
Total Switched Access Lines	**46,307**	49,413	52,356	**(6.3)%**	(5.6)%
Broadband Connections[3]	**8,538**	6,921	5,104	**23.4%**	35.6%

[1]Wireline In-region represents access lines served by AT&T's ILECs (excludes subsidiaries of BellSouth).
[2]Competitive local exchange carriers (CLECs).
[3]Broadband connections include DSL lines of 8,529 in 2006 and 6,921 in 2005, U-verse high-speed Internet access and satellite broadband.

Wireless
Segment Results

				Percent Change[1]	
	2006	2005	2004	**2006 vs. 2005**	2005 vs. 2004
Segment operating revenues					
Service	**$33,756**	$30,638	$17,602	**10.2%**	—
Equipment	**3,750**	3,795	1,963	**(1.2)**	—
Total Segment Operating Revenues	**37,506**	34,433	19,565	**8.9**	—
Segment operating expenses					
Cost of services and equipment sales	**15,056**	14,387	7,611	**4.7**	—
Selling, general and administrative	**11,447**	11,647	7,349	**(1.7)**	—
Depreciation and amortization	**6,436**	6,575	3,077	**(2.1)**	—
Total Segment Operating Expenses	**32,939**	32,609	18,037	**1.0**	—
Segment Operating Income	**4,567**	1,824	1,528	**—**	19.4
Interest Expense	**1,186**	1,260	900	**(5.9)**	40.0
Equity in Net Income (Loss) of Affiliates	**—**	5	(415)	**—**	—
Other – net	**(139)**	(38)	(70)	**—**	45.7
Segment Income	**$ 3,242**	$ 531	$ 143	**—**	—

[1]AT&T Mobility's 2005 operating revenue and expense percentage increases and decreases are not considered meaningful due to AT&T Mobility's fourth-quarter 2004 acquisition of AWE and are denoted with a dash.

Accounting for AT&T Mobility
The wireless segment reflects 100% of the results reported by AT&T Mobility (formerly Cingular), which was our wireless joint venture with BellSouth prior to the December 29, 2006 acquisition and became a wholly-owned subsidiary of AT&T. Prior to the acquisition of BellSouth, we accounted for our 60% economic interest in our AT&T Mobility joint venture under the equity method of accounting in our consolidated financial statements. This means that for periods prior to the acquisition, our consolidated results included AT&T Mobility's results in the "Equity in net income of affiliates" line. Once the acquisition closed and AT&T Mobility became a wholly-owned subsidiary, GAAP requires that results from the wireless segment be included as operating revenues and expenses in our consolidated results. Accordingly, results from this segment for the last two days of 2006 were included as operating revenues and expenses and not in the "Equity in net income of affiliates" line.

When analyzing our segment results, we evaluate AT&T Mobility's results on a stand-alone basis using information provided by AT&T Mobility during the year. For periods before the acquisition, including 100% of AT&T Mobility's results in our wireless segment operations (rather than 60% in equity in net income of affiliates) affected the presentation of this segment's revenues, expenses, operating income, nonoperating items and segment income but did not affect our consolidated net income.

Acquisition of AT&T Wireless Services, Inc. (AWE)
On October 26, 2004, AT&T Mobility acquired AWE for approximately $41,000 in cash. We and BellSouth funded, by means of an equity contribution to AT&T Mobility, a significant portion of the acquisition's purchase price. Based on our 60% equity ownership of AT&T Mobility, and after taking into account cash on hand at AWE, we provided approximately $21,600 to fund the purchase price.

Wireless Customer and Operating Trends
As of December 31, 2006, we served 61.0 million wireless customers, compared to 54.1 million at December 31, 2005 and 49.1 million at December 31, 2004. Wireless customer net additions increased 37.7% in 2006 and 50.0% in 2005 with 54% of the 2006 net additions coming from postpaid customers, 28% from resellers and 18% from prepaid customers. Postpaid customer growth was driven by lower churn, which benefited from network and customer service improvements and continued high levels of advertising over the past year. Also contributing to the increase in net additions was a significant increase in prepaid gross additions. Gross customer additions were 19.2 million in 2006 and 18.5 million in 2005. Postpaid customer gross additions declined due to the streamlining of operations, such as the reduction of retail stores and agents, and fewer customers switching to AT&T Mobility from other providers related to lower industry churn.

Competition, lower industry churn and increased wireless penetration as the wireless market matures will continue to impact wireless gross additions, revenue growth, expenses and put pressure on margins. We expect that future revenue growth will become increasingly dependent on minimizing customer turnover (customer churn) and on increasing service average revenue per user/customer (ARPU).

Our wireless segment ARPU has weakened slightly over the past several years, as we have offered a broader array of plans to expand our customer base, including increased growth among lower-ARPU prepaid and reseller customers. We have also responded to increasing competition, resulting in pricing reductions. Additionally, the increase in prepaid and reseller customers over the past year has contributed to the decline in ARPU. We expect continued pressure on ARPU, despite our increasing revenue from data services.

ARPU declined 1.1% in 2006 due to a decrease in local service, net roaming and other revenue per customer mostly offset by a 44.8% increase in average data revenue per customer and increased long-distance revenue per customer. The continued increase in data revenue was related to increased use of text messaging, Internet access, e-mail and other data services, which we expect to grow as we continue expanding our third-generation (3G) service. ARPU declined 0.1% in 2005 due to a decrease in local service and net roaming revenue per customer virtually offset by an increase of 115% in average data revenue per customer and increased long-distance revenue per customer. In 2006, local service revenue per customer declined primarily due to the addition of a disproportionately higher percentage of prepaid and reseller customers which provide significantly lower ARPU than postpaid customers; customer shifts to all-inclusive rate plans that offer lower monthly charges; free mobile-to-mobile plans that allow our wireless customers to call other AT&T Mobility customers at no charge and, to a lesser extent, "rollover" minutes. An increase in customers on rollover plans tends to lower average monthly revenue per customer, since unused minutes (and associated revenue) are deferred until subsequent months for up to one year.

The effective management of wireless customer churn is critical to our ability to maximize revenue growth and to maintain and improve margins. Wireless customer churn rate is calculated by dividing the aggregate number of wireless customers (primarily prepaid and postpaid) who cancel service during each month in a period by the total number of wireless customers at the beginning of each month in that period. Our wireless segment churn rate was 1.8% in 2006, down from 2.2% in 2005 and 2.7% in 2004. The churn rate for postpaid customers was 1.5% in 2006, down from 1.9% in 2005 and 2.3% in 2004. The decline in postpaid churn reflects continuing benefits from the acquisition of AWE, including more affordable rate plans, broader network coverage and higher network quality, as well as exclusive devices and free mobile-to-mobile calling among our wireless customers.

While we anticipate continued improvements to our wireless network and customer care and more attractive customer offerings, we expect additional disconnects from the ongoing phase out of the former AWE prepaid plans and from customers that have been using the analog and Time Division Multiple Access (TDMA) networks; we plan to cease operating these networks in early 2008. These disconnects, plus the increasing mix of prepaid and reseller customers in our customer base, are expected to pressure churn rates in the future.

We expect cost of services to stabilize due to the substantial completion of our network integration of AWE and reduced payments to T-Mobile USA (T-Mobile) for the use of its network in California and Nevada, and to a lesser extent, lower expenses related to operating, maintaining and decommissioning outdated networks that duplicated our Global System for Mobile Communication (GSM) networks while integrating networks acquired from AWE. AT&T Mobility's remaining purchase commitment to T-Mobile was $202 at December 31, 2006. As of December 31, 2006, more than 91% of AT&T Mobility's customers in California and Nevada were on the AT&T Mobility network.

Wireless Operating Results

Our wireless segment operating income margin was 12.2% in 2006, 5.3% in 2005 and 7.8% in 2004. The higher margin in 2006 was primarily due to revenue growth of $3,073, which exceeded our increase in operating expenses of $330.

The lower margins in 2005 and 2004 were primarily attributable to the acquisition of AWE in late October 2004. Operating expenses increased $14,572 in 2005 and $4,714 in 2004. More than offsetting these operating expenses was revenue growth of $14,868 in 2005. In 2004, revenue growth of $3,988 partially offset the increased operating expenses.

Service revenues are comprised of local voice and data services, roaming, long-distance and other revenue. Service revenues increased $3,118, or 10.2%, in 2006 and $13,036 in 2005 and consisted of:

- Data service revenues increased $1,579, or 59.0%, in 2006 and $1,785 in 2005. The increase in 2006 was related to increased use of text messaging and Internet access services, which resulted in an increase in data ARPU of 44.8%. The increase in 2005 was primarily due to the inclusion of former AWE customers and increased average data revenue per customer related to increased use of text messaging and other data services. Data service revenues represented approximately 12.6% of our wireless segment service revenues in 2006 and 8.7% in 2005.
- Local voice revenues increased $1,515, or 6.0%, in 2006 and $10,219 in 2005. The increase in 2006 was primarily due to an increase in the average number of wireless customers of 11.5%, partially offset by competitive pricing pressures and the impact of various all-inclusive calling and prepaid plans. The increase in 2005 was primarily due to the acquired AWE customer base, as well as increased Universal Service Fund (USF) and regulatory compliance fees.
- Long-distance and other revenues increased $26, or 3.4%, in 2006 and $377 in 2005. The increase in 2006 was a result of increased international long-distance usage, partially offset by a decline in other revenue attributed to property management fees. The increase in 2005 was primarily due to increased long-distance revenues from the acquired AWE customer base as well as increased domestic and international long-distance calling.
- Roaming revenues from our wireless customers and other wireless carriers for use of our wireless segment's network was flat in 2006 and increased $655 in 2005. The significant increase in 2005 was primarily due to roaming revenues from the acquired AWE customer base.

Equipment revenues decreased $45, or 1.2%, in 2006 and increased $1,832 in 2005. The decrease in 2006 was due to a decline in handset revenues as a result of increased rebate and equipment return credits and lower priced handsets, mostly offset by increased handset unit sales and pricing on handset upgrades and accessories attributable to customer purchases of devices with more advanced features. The increased handset unit sales related to the higher gross customer additions and customer upgrades. The increase in 2005 was due to increased handset revenues primarily as a result of significantly higher gross customer additions, primarily related to the acquisition of AWE, and increases in existing customers upgrading their units. Upgrade unit sales reflected an increase in GSM upgrades and our wireless segment's efforts to migrate former AWE customers to our wireless service offerings.

Cost of services and equipment sales expenses increased $669, or 4.7%, in 2006 and $6,776 in 2005. The increase in 2006 was primarily due to increases in network usage and associated network system expansion. The increase in 2005 was primarily due to increased cost of services resulting from the acquired AWE network. Cost of services includes integration costs, primarily for network integration, of $229 in 2006 compared to $195 in 2005. Cost of services in 2005 also includes $97 in hurricane-related costs.

Cost of services increased $491, or 5.3%, in 2006 and $4,581 in 2005. Cost of services increased due to the following:

- Increases in network usage with a total system minutes-of-use (MOU) increase of 20.6% in 2006 and more than 110% in 2005 related to the increase in customers. Additionally, average MOU's per customer increased 8.2% in 2006 and 20.0% in 2005. The significant increase in 2005 was primarily due to the increase in subscribers related to AT&T Mobility's acquisition of AWE.
- Higher roaming and long-distance costs, partially offset by a decline in reseller expenses in 2006. The reseller decrease resulted from a decrease in minutes of use on the T-Mobile network of more than 50% for 2006. In 2005, higher roaming and long-distance costs and increased USF and regulatory fees related to the increase in the customer base.
- Increased payments in 2005 to T-Mobile for the use of its network in California and Nevada, as well as expenses related to operating, maintaining and decommissioning TDMA networks that duplicated GSM networks while integrating the networks acquired from AWE.

Equipment sales expenses increased $178, or 3.5%, in 2006 and $2,195 in 2005. The increase in 2006 was due to increased handset upgrades of 11.2% and an increase in the average cost per upgrades and accessories sold, partially offset by the decline in the average cost per handset sold to new customers. The increase in 2005 was primarily due to higher handset unit sales associated with the 46.1% increase in gross customer additions in 2005, existing customers upgrading their units and the continued migration of former AWE customers to AT&T Mobility service offerings, which required new handsets. Total equipment costs continue to be higher than equipment revenues due to the sale of handsets below cost to customers who committed to one-year or two-year contracts or in connection with other promotions.

Selling, general and administrative expenses decreased $200, or 1.7%, in 2006 and increased $4,298 in 2005. The decline in 2006 was due to decreases in general and administrative expenses of $296, partially offset by an increase in selling expenses of $96. The increase in 2005 expenses was due to increases in general and administrative expenses of $2,913, primarily due to the acquisition of AWE, and selling expenses of $1,385 due to the increase in gross customer additions previously mentioned.

The decline in selling, general and administrative expenses in 2006 was due to the following:

- Decreases in billing and bad debt expense of $378 primarily due to fewer account write-offs and cost-savings related to transitioning to one billing system.
- Decreases in other administrative expense of $108 due to a decline in legal related expenses, lower employee costs and employee-related benefits due to a decrease in the number of employees, lower IT and other professional services expense and a federal excise tax refund accrual.
- Decreases in customer service expense of $87 due to a decline in the number of outsourced call center professional services and lower billing expenses.
- Increases of $147 primarily related to increased prepaid card replenishment costs and higher migration and upgrade transaction costs.
- Increases in other expense of $130 due to higher warranty, refurbishment and freight costs.
- Increases in selling expense of $96 due to an increase in sales expense, partially offset by a decrease in net commission expenses. The decline in net commission expense was due to reductions in average activation and agent branding expense, partially offset by an increase in direct commission expense.

The increase in selling, general and administrative expenses in 2005 was due to the following:

- Increases in customer service expense of $960 due to a higher number of employees and employee-related expenses related to the significant increase in customers as well as customer retention and customer service improvement initiatives.
- Increases in other administrative expense of $926 primarily due to incremental expenses associated with the acquired AWE administrative functions.
- Increases in billing, bad debt and other customer maintenance expense of $766 primarily due to the significant increase in AT&T Mobility's customer base.
- Increases in commission expense of $494 and advertising and marketing expense of $429.
- Increases in sales expense of $462 primarily due to increased sales personnel costs associated with the acquired AWE sales force.
- Increases in upgrade commissions of $261 due to the increased customer migration and handset upgrade activity.

The expenses above also include integration costs of $123 in 2006 and $264 in 2005, such as employee-termination costs, re-branding and advertising and customer service and systems integration costs.

Depreciation and amortization expenses decreased $139, or 2.1%, in 2006 and increased $3,498 in 2005.

Depreciation expense increased $310, or 6.4%, in 2006 primarily due to depreciation associated with the property, plant and equipment related to ongoing capital spending for our GSM network, partially offset by expense declines due to equipment that had become fully depreciated in 2006. Depreciation expense increased $2,249 in 2005 primarily due to incremental depreciation associated with the property, plant and equipment acquired in the AWE acquisition along with depreciation related to AT&T Mobility's expansion of its GSM network and accelerated depreciation on certain TDMA network and other network assets based on the projected transition of network traffic to our GSM network. The 2005 increase included $417 of integration costs.

Amortization expenses decreased $449, or 25.5%, in 2006 and increased $1,249 in 2005. The decline in 2006 was due to declining amortization of the AWE customer contracts and other intangible assets acquired, which are amortized using an accelerated method of amortization. The increase in 2005 was primarily due to a full year's amortization of the AWE customer contracts and other intangible assets acquired in October 2004.

Dollars in millions except per share amounts

Directory
Segment Results

				Percent Change	
	2006	2005	2004	**2006 vs. 2005**	2005 vs. 2004
Total Segment Operating Revenues	**$3,702**	$3,714	$3,759	**(0.3)%**	(1.2)%
Segment operating expenses					
Cost of sales	**1,117**	1,104	1,022	**1.2**	8.0
Selling, general and administrative	**643**	611	622	**5.2**	(1.8)
Depreciation and amortization	**3**	5	9	**(40.0)**	(44.4)
Total Segment Operating Expenses	**1,763**	1,720	1,653	**2.5**	4.1
Segment Operating Income	**1,939**	1,994	2,106	**(2.8)**	(5.3)
Equity in Net Income (Loss) of Affiliates	**(17)**	(5)	—	**—**	—
Segment Income	**$1,922**	$1,989	$2,106	**(3.4)%**	(5.6)%

In September 2004, we sold our interest in the directory advertising business in Illinois and northwest Indiana. Our directory segment results exclude the results of those operations (see Note 15). In December 2004, our directory segment entered into a joint venture agreement with BellSouth and acquired the Internet directory publisher, YPC. Prior to the December 29, 2006, acquisition of BellSouth (see Note 2), we accounted for our 66% economic interest in YPC under the equity method, since we shared control equally with BellSouth, our 34% economic partner. We had equal voting rights and representation on the board of directors that controlled YPC. Following the BellSouth acquisition, YPC became a wholly-owned subsidiary of AT&T and results will be reflected in operating revenues and expenses on our Consolidated Statements of Income.

Our directory segment operating income margin was 52.4% in 2006, 53.7% in 2005 and 56.0% in 2004. The segment operating income margin decrease in 2006 and 2005 was a result of both higher expenses and lower revenues.

Operating revenues decreased $12, or 0.3%, in 2006 and decreased $45, or 1.2%, in 2005. The decrease in revenues in 2006 was primarily due to a decrease of $93 in our Yellow Pages print advertising, which was partially offset by an increase of $75 in Internet advertising revenue. Revenues in 2005 decreased primarily due to a decrease of $74 in our local Yellow Pages print advertising, which was partially offset by an increase of $39 in Internet advertising revenue. These results reflect the impact of competition from other publishers, other advertising media and continuing economic pressures on advertising customers.

Cost of sales increased $13, or 1.2%, in 2006 and increased $82, or 8.0%, in 2005. The increase in 2006 was primarily due to higher costs for Internet traffic of $20, partially offset by a decrease in printing costs of $5. In 2005, cost of sales increased due to higher costs for Internet traffic of $22, publishing of $17 and distribution of $9.

Selling, general and administrative expenses increased $32, or 5.2%, in 2006 and decreased $11, or 1.8%, in 2005. Increased expenses in 2006 were primarily due to increases in other directory segment costs, including brand advertising and employee benefits of $102, partially offset by lower bad debt expense of $74. The expense reduction in 2005 was primarily due to lower advertising expense.

Other
Segment Results

				Percent Change	
	2006	2005	2004	**2006 vs. 2005**	2005 vs. 2004
Total Segment Operating Revenues	**$ 954**	$745	$706	**28.1%**	5.5%
Total Segment Operating Expenses	**977**	792	803	**23.4**	(1.4)
Segment Operating Income (Loss)	**(23)**	(47)	(97)	**51.1**	51.5
Equity in Net Income of Affiliates	**2,060**	614	873	**—**	(29.7)
Segment Income	**$2,037**	$567	$776	**—**	(26.9)%

Our other segment operating results consist primarily of Sterling, corporate, other operations and, with the closing of the BellSouth merger on December 29, 2006, BellSouth's operating results for the two days after the merger close. Sterling provides business-integration software and services.

Operating revenues increased $209, or 28.1%, in 2006 and $39, or 5.5%, in 2005. The increase in 2006 is primarily due to operating revenue from BellSouth, increased intercompany revenue from our captive insurance company (shown as intersegment revenue in Note 4) and improved operating revenue at Sterling, partially offset by a decrease in revenue as a result of the sale of our paging subsidiary in November 2005. Revenue increased in 2005 primarily due to improved operating revenue at Sterling.

Operating expenses increased $185, or 23.4%, in 2006 and decreased $11, or 1.4%, in 2005. The increase in 2006 is primarily due to the addition of BellSouth expenses, increased operating expenses at Sterling and at our captive insurance company, partially offset by management fees paid in 2005 that did not recur in 2006.

Our other segment includes our 60% proportionate share of AT&T Mobility results as equity in net income of affiliates. With the December 29, 2006 close of the BellSouth merger, we own 100% of AT&T Mobility and its results for the final two days of the year have been excluded from equity in net income of affiliates. Our other segment also includes our equity investments in international companies, the income from which we report as equity in net income of affiliates. Our earnings from foreign affiliates are sensitive to exchange-rate changes in the value of the respective local currencies. Our foreign investments are recorded under GAAP, which include adjustments for the purchase method of accounting and exclude certain adjustments required for local reporting in specific countries. Our equity in net income of affiliates by major investment is listed below:

	2006	2005	2004
AT&T Mobility	**$1,508**	$200	$ 30
América Móvil	**274**	198	132
Telmex	**222**	212	180
TDC[1]	**—**	—	328
Telkom South Africa[1]	**—**	—	115
Other	**56**	4	88
Other Segment Equity in Net Income of Affiliates	**$2,060**	$614	$873

[1]Investment sold in 2004.

Equity in net income of affiliates increased $1,446 in 2006 primarily due to the improved operating results at AT&T Mobility. Equity in net income decreased $259, or 29.7%, in 2005 due primarily to foregone equity income from the disposition of investments.

Supplemental Information
BellSouth Results

In order to help investors track business trends, we are providing the following supplemental information on BellSouth's pro forma operating results through December 31, 2006, consistent with BellSouth's previously reported quarters prior to its acquisition by AT&T. Accordingly, amounts in this section are adjusted to include results for the last two days of 2006.

Following GAAP, BellSouth used the equity method of accounting for its investment in AT&T Mobility. BellSouth's 40% proportionate share of AT&T Mobility's earnings was reported as net earnings of equity affiliates in its consolidated income statements.

BellSouth's Unaudited Pro Forma Condensed Combined Statements of Income[1]

	Three-Month Period Ended			
	12/31/06	09/30/06	06/30/06	03/31/06
Total Operating Revenues	$5,242	$5,218	$5,206	$5,171
Total Operating Expenses	3,771	3,773	3,901	3,925
Operating Income	$1,471	$1,445	$1,305	$1,246

[1]Amounts for the first three quarters were reported on Form 10-Q, filed with the Securities and Exchange Commission (SEC). The fourth-quarter 2006 amounts are consistent with BellSouth's previously reported quarters prior to its acquisition by AT&T.

Operating revenues increased in 2006 attributable to growth in DSL, long distance, wholesale wireless transport and emerging data services as well as electronic media and print services. The year-over-year growth in consolidated revenues was positively impacted by one-time credits issued during 2005 to customers affected by Hurricane Katrina. This growth was partially offset by revenue declines associated with competitive access line losses in the retail residence and wholesale voice sectors. At the end of 2006, BellSouth had nearly 18.8 million access lines, down 6.4% from one year ago. The rate of year-over-year total access line decline slowed in the last two quarters of 2006 primarily due to moderating retail residential line losses. BellSouth's wholesale line base, which consists primarily of UNE-P lines, declined 638,000 during 2006.

Operating expenses continued to be impacted by service restoration and network-repair activities carrying over from Hurricanes Katrina and Wilma in late 2005. These costs, net of insurance recoveries, were less than the weather-related spending of 2005 resulting in an overall decrease in storm-related expenses. Operating expenses also decreased due to lower USF related settlement charges, lower depreciation, amortization and restructuring charges as well as lower labor costs from workforce reductions and declines in project spending. These decreases were partially offset by costs associated with the AT&T merger and expansion and growth of electronic media and print services.

Access Line Summary

BellSouth's Communications Group network access lines in service at December 31, 2006 and 2005 are shown below:

Network Access Lines in Service

(In 000s)	2006	2005	Percent Change 2006 vs. 2005
Residence Retail			
Primary	**10,828**	11,319	**(4.3)%**
Additional	**1,014**	1,163	**(12.8)**
Residence Retail Subtotal	**11,842**	12,482	**(5.1)**
Residence Wholesale Voice Lines[1]	**1,013**	1,488	**(31.9)**
Residence Subtotal	**12,855**	13,970	**(8.0)**
Business Retail	**5,301**	5,306	**(0.1)**
Business Wholesale Voice Lines	**518**	668	**(22.5)**
Business Subtotal[1]	**5,819**	5,974	**(2.6)**
Total Other Retail/ Wholesale Lines	**81**	93	**(12.9)**
Total Switched Access Lines[2]	**18,755**	20,037	**(6.4)%**
DSL and DirecTV customers[3]	**4,450**	3,405	**30.7%**

[1]Includes 205 Residence Wholesale Voice Lines and 57 Business Lines sold to ATTC at December 31, 2006.
[2]Using AT&T methodology for calculating switched access lines, BellSouth's Total Switched Access Lines at December 31, 2006 was 20,163.
[3]DSL and DirecTV customers include DSL lines of 3,632 in 2006 and 2,882 in 2005.

OPERATING ENVIRONMENT AND TRENDS OF THE BUSINESS

2007 Revenue Trends Our acquisitions of ATTC, BellSouth and BellSouth's 40% economic interest in AT&T Mobility continue to change the focus of our company toward being a broadband/data and wireless service provider. Because of the late 2006 completion of the BellSouth acquisition, we expect reported revenues to substantially increase in 2007 compared to 2006 as we include the operating revenues of both BellSouth and AT&T Mobility in our consolidated operating revenues. We expect our sole ownership of AT&T Mobility will enhance our bundling opportunities (see "AT&T Mobility" discussed in "Expected Growth Areas"). We also expect to expand services in the national business market, to utilize our broadband network and to move toward wireless and wireline convergence. Recently we announced our AT&T Unity[SM] initiative which combines residential, business and wireless calling and allows for free domestic calls to and from AT&T wireline and wireless numbers. However, we also expect that increasing competition in the communications industry, including the continued growth of comparable alternatives, such as wireless, cable and VoIP, and our response to competitors' pricing strategies will pressure revenue.

2007 Expense Trends Acquisition and related merger costs will adversely affect expenses in 2007 and 2008. We expect that our operating income margin, adjusted to exclude these costs, will expand in 2008 due primarily to expected improvement in our revenues and continued cost-control measures. In particular, we expect to continue net workforce reductions over the next three years related to merger synergies and other operational initiatives. Expenses related to growth initiatives, such as Project Lightspeed (see "U-verse Services" discussed in "Expected Growth Areas") will apply some pressure to our operating income margin.

OPERATING ENVIRONMENT OVERVIEW

AT&T subsidiaries operating within the U.S. are subject to federal and state regulatory authorities. AT&T subsidiaries operating outside the U.S. are subject to the jurisdiction of national regulatory authorities in the market where service is provided, and regulation is generally limited to operational licensing authority for the provision of enterprise (i.e., large business) services.

In the Telecommunications Act of 1996 (Telecom Act), Congress established a national policy framework intended to bring the benefits of competition and investment in advanced telecommunications facilities and services to all Americans by opening all telecommunications markets to competition and reducing or eliminating burdensome regulation. Since the Telecom Act was passed, the Federal Communications Commission (FCC) and some state regulatory commissions have maintained many of the extensive regulatory requirements applicable to our traditional wireline subsidiaries. We are actively pursuing additional legislative and regulatory measures to reduce or eliminate regulatory requirements that inhibit our ability to provide the full range of services demanded by our customers. For example, we are supporting legislative efforts at both the state and federal levels, as well as proposed rules at the FCC, that would offer a streamlined process for new video service providers to compete with traditional cable television providers. Several states have passed legislation that enables new video entrants to acquire a statewide franchise to offer video services. In addition, we are supporting efforts to update regulatory treatment for retail services. Passage of legislation is uncertain and depends on many factors.

Our wireless operations are likewise subject to substantial governmental regulation. Wireless communications providers must be licensed by the FCC to provide communications services at specified spectrum frequencies within specified geographic areas and must comply with the rules and policies governing the use of the spectrum as adopted by the FCC. Licenses are issued for only a fixed period of time, typically 10 years. Consequently, we must periodically seek renewal of those licenses. The FCC has routinely renewed wireless licenses in the past. However, licenses may be revoked for cause, and license renewal applications may be denied if the FCC determines that a renewal would not serve the public interest. In addition, the FCC and the states are increasingly looking to the wireless industry to fund various initiatives, including universal service programs, local telephone number portability, services for the hearing-impaired and emergency 911 networks. While wireless communications providers' prices and service offerings are generally not subject to state regulation, an increasing number of states are attempting to regulate or legislate various aspects of wireless services, such as in the area of consumer protection.

The term "net neutrality" refers to a principle that underlies the design of the Internet (or any network) as non-selective, or neutral, about the transport of content through the network. We believe that segregating the transport of content according to a customer's priority (using a tiered services pricing model) will allow us to provide advanced functionality and higher quality to those customers desiring the highest speeds and/or the highest volumes while maintaining, at lower prices, the bandwidth or quality of service desired by the public. We comply with the FCC's four net neutrality principles, which essentially ensure that end-users can access their content of choice, and reach their application or service provider of choice over the Internet. In connection with receiving the FCC's approval, we agreed to certain commitments related to net neutrality (see "BellSouth Merger Commitments" discussion in "Regulatory Developments").

Because of opportunities made available by the continued changing regulatory environment and our acquisition of BellSouth, including the consolidation of AT&T Mobility, we expect that our capital expenditures will be in the mid-teens as a percentage of total revenues in both 2007 and 2008. This amount includes capital for Project Lightspeed, wireless high-speed networks and merger-integration projects (see "U-verse Services (Project Lightspeed)" and "Wireless" discussed in "Expected Growth Areas"). Despite a slightly more positive regulatory outlook and these broadband opportunities, increasing competition and the growth of comparable alternatives such as cable, wireless and VoIP have created significant challenges for our business.

Expected Growth Areas
We expect our primary wireline products and wireless services to remain the most significant portion of our business and have also discussed trends affecting the segments in which we report results for these products (see "Wireline Segment Results" and "Wireless Segment Results"). Over the next few years we expect an increasing percentage of our growth to come from: (1) our wireless service, and (2) data/broadband, through existing services and new services to be provided by our Project Lightspeed initiative. We expect that our recent acquisitions will strengthen the reach and sophistication of our network facilities, increase our large-business customer base and enhance the opportunity to market wireless services to that customer base. Whether, or the extent to which, growth in these areas will offset declines in other areas of our business is not known.

U-verse Services (Project Lightspeed) In June 2004, we announced key advances in developing a network capable of delivering a new generation of integrated digital television, high-speed broadband and VoIP services to our residential and small-business customers. We have been building out this network in numerous locations and are now providing AT&T U-verse services, including U-verse TV (IPTV) video, in limited parts of 11 markets as of year-end 2006, and we expect to launch additional markets during 2007. Our deployment strategy is to enter each market on a limited basis in order to ensure that all operating and back-office systems are functioning successfully and then expand within each market as we continue to monitor these systems to ensure customer satisfaction with our services. In these market expansions, we expect to continue to use contracted outside labor in addition to our employees as installers; our rate of expansion will be slowed if we cannot hire and train an adequate number of technicians to keep pace with customer demand. During our launch into these additional markets, we also expect to add additional features to our IP video service offering. We expect to have the capability to offer service to approximately 19 million living units by the end of 2008, as part of our initial deployment, and expect to spend approximately $4,600 in network-related deployment costs and capital expenditures from 2006 through 2008, as well as additional customer activation capital expenditures. We remain on budget for this overall target and expect to spend approximately $3,100 during 2007 and 2008. These expenditures may increase slightly if the programming and features of the video offering expand or if additional network conditioning is required.

With respect to our IP video service, we continue to work with our vendors to continue to improve, in a timely manner, the requisite hardware and software technology. Our deployment plans could be delayed if we do not receive required equipment and software on schedule. We have completed most negotiations, and consistent with our profitability assumptions, with programming owners (e.g., movie studios and cable networks) to offer existing television programs and movies and, if applicable, other new interactive services. Also, as discussed in the "Regulatory Developments" section, we are supporting legislation at the state level that would streamline the regulatory process for new video competitors to enter the market.

We believe that IPTV is subject to federal oversight as a "video service" under the Federal Communications Act. However, some cable providers and municipalities have claimed that certain IP services should be treated as a traditional cable service and therefore subject to the applicable state and local regulation, which could include the requirement to pay fees to obtain local franchises for our IP video service. Certain municipalities have refused us permission to use our existing right-of-ways to deploy or activate our U-verse-related services and products, resulting in litigation. Pending negotiations and current or threatened litigation involving municipalities could delay our deployment plans in those areas for 2007 and future years. If the courts were to decide that state and local regulation were applicable to our U-verse services, it could have a material adverse effect on the cost, timing and extent of our deployment plans.

Wireless AT&T Mobility began operations in October 2000 as a joint venture between us and BellSouth. In October 2004, AT&T Mobility completed its acquisition of AWE, which established AT&T Mobility as the largest provider of mobile wireless voice and data communications services in the U.S. in terms of subscribers. Following our December 2006 acquisition of BellSouth, AT&T Mobility became a wholly-owned subsidiary. At December 31, 2006, we served approximately 61 million customers and had access to licenses to provide wireless communications services covering an aggregate population of 296 million, or approximately 99% of the U.S. population, including most of the 100 largest U.S. metropolitan areas.

Our wireless networks use equipment with GSM and TDMA digital transmission technologies. We are transitioning our subscribers to GSM technology, and over 99% of our total usage, based on minutes of use, is on our GSM network. We will decommission our TDMA network in early 2008. Our GSM networks also contain General Packet Radio Service (GPRS) and Enhanced Data Rates for Global Evolution (EDGE) technology to provide high-speed wireless data services. In the majority of the U.S. domestic markets we are also completing deployment of UMTS/HSDPA (or Universal Mobile Telecommunications System/High Speed Downlink Packet Access), a 3G technology that allows customers to access the Internet from their wireless devices at superior speeds for data and video services.

We expect that intense industry competition and market saturation may cause the wireless industry's customer growth rate to moderate in comparison with historical growth rates. While the wireless telecommunications industry continues to grow, a high degree of competition exists among four national carriers, their affiliates and smaller regional carriers. This competition will continue to put pressure upon pricing and margins as the carriers compete for potential customers. However, as wireless Internet connectivity and wireline/wireless convergence are realized, we expect increased demand for high-speed wireless and wireless data services. Future carrier revenue growth is dependent upon the number of net customer additions a carrier can achieve and the revenue per customer. The effective management of customer turnover, or churn, is also important in minimizing customer acquisition costs and maintaining and improving margins and customer growth.